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USCIS Says New Passport Card Is Acceptable for Employment Eligibility Verification

U.S. Citizenship and Immigration Services (USCIS) has announced that the new U.S. passport card may be used in the Form I-9 (*Employment Eligibility Verification*) process [USCIS Press Release, 8-8-08; www.uscis.gov/portal/site/uscis (click on "Press Room")].

The new passport card is a less expensive and more portable alternative to the traditional passport book, and is intended to expedite document processing at U.S. land and sea ports-of-entry for U.S. citizens traveling to Canada, Mexico, the Caribbean, and Bermuda.

While the new card is more limited in its uses for

international travel (e.g., it may not be used for international air travel), it is a valid passport that attests to the U.S. citizenship and identity of the bearer. Accordingly, it may be used for the Form I-9 process and can also be accepted by employers participating in the E-Verify program.

The passport card is considered a "List A" document that may be presented by newly hired employees during the employment eligibility verification process to show identity and work authorized status. *Note:* List A documents are those used by employees to prove both identity and work authorization when completing Form I-9. ■

GAO Issues Report on Billions in Federal Payroll Taxes Owed by Businesses, Inadequate IRS Collection Efforts

The Government Accountability Office has released a report prepared for two Senate committees titled "Businesses Owe Billions in Federal Payroll Taxes" [GAO-08-617, 7-25-08; www.gao.gov/new.items/d08617.pdf]. On July 29, 2008, Steven J. Sebastian, GAO Director, Financial Management and Assurance, testified before the Permanent Subcommittee on Investigations, Senate Committee on Homeland Security and Government Affairs, about the report [GAO-08-1034T, 7-29-08; www.gao.gov/new.items/d081034t.pdf].

Background: the tax gap

There is a significant gap between what taxpayers should pay and what the IRS actually collects. The IRS estimates that the annual net tax gap – the amount of taxes that go unidentified and

uncollected each year – amounts to nearly \$300 billion.

Payroll taxes. One of the elements of the tax gap is unpaid payroll taxes. These are the amounts withheld from an employee's salary for federal individual income and FICA (social security and Medicare) taxes, along with the employer's matching portion of FICA taxes.

Objectives of the report. The objectives of the report were to determine:

- the magnitude of the unpaid federal payroll tax debt;
- the factors affecting the IRS's ability to enforce compliance or pursue collections against businesses with unpaid payroll taxes; and
- whether some businesses with unpaid payroll taxes are

Payroll Solutions

Q. Our company has a PTO (personal time off) plan that allows employees to carry over unused vacation days, sick days, etc., from year to year. We would like to give employees the option of receiving cash for this unused time instead. If employees choose this option, does the Fair Labor Standards Act (FLSA) require us to count the payment when calculating overtime for our nonexempt employees?

A. No. The FLSA requires overtime pay only for hours *physically worked* over 40 in a workweek. Hours that employees are paid for but during which no actual work is done do not have to be counted when calculating the number of hours worked (see *The Payroll Source*®, p. 2-38).

Under the FLSA, overtime is computed at 1½ times the employee's regular rate of pay. This is generally an hourly pay rate determined by dividing the total regular pay *actually earned* for the workweek by the total number of hours worked. Thus, payments received for time not worked because of holidays, illness, vacations, jury duty, bereavement, or the failure of the employer to provide sufficient work (not layoffs or reduced schedules) need not be included in an employee's regular rate of pay.

Note: While these payments are not included in an employee's regular rate of pay for purposes of determining overtime pay due, they also cannot be used as an offset against any overtime pay due (see *The Payroll Source*®, p. 2-41).

engaged in abusive or potentially criminal activities with regard to the federal tax system.

Magnitude and composition of unpaid federal payroll taxes

The GAO reports that over 1.6 million businesses owed over \$58 billion in unpaid payroll taxes as of September 30, 2007, and over 100,000 businesses currently owe more than 2 years (8 quarters) of payroll taxes. *Note:* The top industries with unpaid payroll tax debt include construction (\$8.6 billion), professional services (\$4.4 billion), and healthcare (\$4 billion).

Trends. Much of the outstanding payroll tax debt has been outstanding for several years. GAO analysis of IRS records shows that over 60% of unpaid payroll taxes are owed for tax periods before 2003.

From 1998, when the GAO performed its last in-depth review of payroll taxes, to September 2007, the number of businesses with payroll tax debt decreased from 1.8 million to 1.6 million, but the balance of outstanding payroll taxes increased from \$49 billion to \$58 billion.

The number of businesses with more than 5 years of unpaid payroll tax debt more than doubled between 1998 and 2007, while the number of businesses with more than 10 years of unpaid payroll tax debt increased almost 500%.

IRS collection approach does not always prevent the accumulation of unpaid payroll taxes

The IRS's approach focuses on voluntary compliance, even for egregious payroll tax offenders. The IRS subordinates the use of some of its collection tools in order to seek voluntary compliance. Repeated attempts to gain voluntary compliance often result in minimal or no actual collections. GAO auditors found that IRS revenue officers continue to work with businesses to gain voluntary compliance while the businesses continue to accumulate unpaid payroll taxes. For example, GAO analysis of the IRS inventory of unpaid payroll taxes found that over 14,000 businesses owed payroll taxes for 20 or more quarters – 5 years or more.

Update. The IRS has recently strengthened its procedures to include some specific steps for dealing with businesses that repeatedly fail to remit payroll taxes and to stress the importance of preventing the further accumulation of such payroll taxes.

The IRS does not always file tax liens timely. GAO auditors found that the IRS does not always file tax liens to protect the government's interest, and when it does file, it does not always file timely. Failure to file a tax lien can have a negative effect on collections.

According to IRS policy, which treats payroll tax cases as high

priority, assessments must be assigned to a revenue officer for face-to-face collection instead of being routed to the Automated Collection System (ACS). Cases are placed in a queue awaiting assignment until a revenue officer is available. They can be in the queue for extended periods awaiting assignment. For the period that a case is in the queue, revenue officers are not assigned to file liens and take other collection actions. As a result, lower priority tax cases that go through the ACS process may have liens filed faster than higher priority payroll tax cases.

The IRS does not always assess trust fund recovery penalties (TFRP) timely. Responsible owners and officers may be held personally liable for unpaid payroll taxes through assessment of a TFRP. However, the GAO found that the IRS often takes a long time to determine whether to hold the owners/officers of businesses personally liable and, once the decision is made, to actually assess penalties against them for taxes. For example, GAO auditors found that revenue officers, once assigned to a payroll tax case, took an average of over 40 weeks to decide whether to pursue a TFRP against business owners/officers and an additional 40 weeks on average to formally assess the TFRP. In 5 of the 76 sampled cases, the IRS took over 4 years to assess the TFRP.

Failure to timely assess a TFRP can result in businesses continuing to accumulate unpaid payroll taxes and lost opportunities to collect these taxes from the owners/officers of the businesses.

Update. The IRS has implemented new requirements to address the timeliness of TFRP assessments (120 days to determine whether to pursue a TFRP after case assignment and 120 days to complete the assessment after that). However, the new policy maintains a provision that allows the revenue officer to delay the TFRP determination, and does not require monitoring of the new standards for assessing TFRPs.

The IRS approach for businesses and responsible parties is inconsistent. The IRS assigns a higher priority to collection efforts against a business with unpaid taxes than the business's responsible owners/officers. Further, it treats the TFRP assessments as a separate collection effort even though the business payroll tax liabilities and the TFRP assessments are essentially the same tax debt (a view reinforced by the practice of crediting all related parties' accounts whenever a collection is made against either assessment).

Accordingly, the IRS often does not assign the TFRP assessment to a revenue officer for collection, and when it does, it may not assign it to the same revenue officer who is responsible for collecting unpaid taxes from the business.

The GAO asserts that assigning the collection efforts against

the business and the TFRP assessments to different revenue officers can result in the responsible owners/officers being able to continue to use the business to fund a personal lifestyle while not remitting payroll taxes. For egregious cases, it says that taking strong collection actions against the owners' personal assets might be a more effective means of either getting the business to be compliant or convincing the owner to close the noncompliant business to prevent the further accumulation of unpaid payroll taxes.

The IRS approach does not prevent the egregious accumulation of unpaid payroll taxes. Despite aggressive policy statements, the IRS successfully pursued fewer than 700 actions to seize business assets in fiscal year 2007 (the GAO was unable to determine how many of these were taken against payroll tax debtors), and obtained fewer than 10 injunctions to stop businesses from accumulating additional payroll taxes (or face closure). The GAO asserts that to the extent the IRS is not taking effective steps to deal with egregious payroll tax offenders, businesses may continue to withhold taxes from employees' salaries but divert the funds for other purposes.

Update. The IRS is piloting a Streamline Injunctive Relief Team to identify cases and develop procedures to quickly move a case from administrative procedures to judicial actions.

The IRS approach does not measure effectiveness. The IRS has not established goals or measures to assess its progress in collecting or preventing the accumulation of payroll tax debt. Workload reports for local managers contain relevant information, but they are not used to monitor program effectiveness. And overall collection statistics do not specifically address unpaid payroll taxes. Such performance measures could be useful to serve as an early warning system to management or as a vehicle for improving the IRS's approach or actions.

The IRS approach could benefit from additional tools. Based on discussions with IRS revenue officers, the GAO asserts that having additional tools could allow the Service to more effectively deal with recalcitrant businesses. Several states are already using the types of tools the IRS revenue officers said would be helpful to them. For example:

- An increasing number of states are seeking to increase tax collections by publicizing the names of those with delinquent tax bills. Public disclosure of tax debtors can be very effective. Just threatening to publish the names of tax offenders can bring some into compliance, while actually appearing on a tax offender list can bring about societal pressure to comply. The potential public disclosure of tax debtors may also encourage greater tax compliance among the general population of taxpayers to avoid potentially being on the list.

- Several states use legal authorities to assist in identifying levy sources. They use matching programs or enter into agreements with financial institutions to match bank account information against state tax debts. This matching allows states to more easily identify potential levy sources and simplifies the financial institution's obligations to respond to multiple levies.

Update. The IRS is investigating the potential for this matching but has not yet sought legislation or agreements with financial institutions.

Businesses engaged in abusive and potentially criminal activity related to the federal tax system

GAO auditors identified tens of thousands of businesses that filed 10 or more tax returns acknowledging that the business owed payroll taxes, yet failed to remit those taxes to the government. While much of the tax debt may be owed by those with little ability to pay, some abuse the tax system, willfully diverting amounts withheld from their employees' salaries to fund their business

operations or their own personal lifestyle.

In addition to owing payroll taxes for multiple tax periods and accumulating tax debt for years, many of the owners and officers of these businesses are repeat offenders. Auditors identified owners who were involved in multiple businesses, all of which failed to remit payroll taxes as required.

Auditors conducted 50 case studies, 12 of which showed abuse and potential criminal activity related to the tax system.

Consequences of failing to take prompt, aggressive collection actions

The GAO urges prompt collection action because as unpaid taxes age, the likelihood of collecting all or a portion of the amount owed decreases. The business owing the taxes may be defunct, insolvent after bankruptcy, or experiencing financial hardship. For example, of the unpaid payroll tax cases the IRS has classified as currently not collectible, almost 70% are as a result of the business being defunct.

Further, the continued accrual of interest and penalties on the outstanding federal taxes can, over time, eclipse the original tax obligation. And the IRS is statutorily limited in the length of time it has to collect unpaid taxes – generally 10 years from the date the tax debt is assessed. Once that statutory period expires, the IRS can no longer attempt to collect the tax. IRS records indicate that over \$4 billion of unpaid payroll taxes will expire in each of the next several years because of the expiration of their statutory collection period.

The GAO asserts that failing to take more aggressive collection actions against businesses that repeatedly fail to remit payroll taxes has a broader impact than on just a single business:

- If left to accumulate unpaid payroll taxes, a business can gain an unfair advantage over its competitors at the expense of the government. The noncompliant business can use the funds that should have been remitted for taxes to either lower overall business costs or increase profits, thus enriching tax abusers or prolonging the demise of a failing business.

Businesses that fail to remit payroll taxes may also underbid tax-compliant businesses, causing them to lose business and encouraging them to also become noncompliant.

- Unpaid balances (taxes as well as associated interest and penalties) may compound beyond the business's ability to pay, ultimately placing the business and responsible officers in greater financial jeopardy.

- States and other creditors benefit from the IRS's approach because they are able to collect unpaid business debts before the IRS.

- Allowing businesses to continue to not remit payroll taxes affects the general public's perception of the fairness of the tax system, a perception that may result in lower overall compliance.

- Because of the failure of businesses to remit payroll taxes, the burden of funding the nation's commitments, including social security and Medicare payments, falls more heavily on taxpayers who willingly and fully pay their taxes.

- In an era of growing federal deficits and amid reports of an increasingly gloomy fiscal outlook, the federal government cannot afford to allow businesses to continue to accumulate unpaid payroll tax debt with little consequence.

Recommendations

- Develop a process to monitor collection actions taken by revenue officers against egregious payroll tax offenders to ensure that those actions appropriately use all available *Internal Revenue Manual* collection tools.

- Review current case prioritization and assignment practices to determine if enforcement and collection procedures could be

enhanced by requiring, to the maximum extent feasible, that businesses with egregious payroll tax debt and the responsible owners/officers with a TFRP assessment be treated as a single unified and coordinated collection effort assigned to a single revenue officer.

- Develop and implement procedures to expeditiously file a *Notice of Federal Tax Lien* against property as soon as possible after payroll tax debt is identified (including cases in the queue awaiting assignment) and ensure that liens are filed on both businesses with unpaid payroll taxes and owners/officers assessed a TFRP.

- Develop and implement procedures to monitor and report on revenue officers' compliance with the new TFRP assessment time frames to ensure that the officers are making TFRP

determinations and assessments in a timely manner.

- Develop performance goals and measures that specifically evaluate the accumulation of unpaid payroll taxes by businesses (especially egregious businesses with over 20 quarters of payroll tax debt), the extent and timeliness of TFRP assessments, and the effectiveness of actions taken to collect unpaid payroll taxes and TFRP assessments.

- Work with states that have developed procedures for matching financial accounts to tax debts to evaluate the potential for the IRS to either develop and implement similar measures or partner with states that currently have that tool to leverage their efforts to assist revenue officers in identifying a business's leviable assets. ■

Annual Federal Per Diem Rates Issued

The General Services Administration (GSA) has issued its annual updated list of federal maximum per diem rates for travel to locations within the continental United States (CONUS). FTR Per Diem Bulletin 09-1 is effective for travel undertaken on or after October 1, 2008 [73 F.R. 46271, 8-8-08]. The Bulletin is available on the APA website at www.americanpayroll.org/members/Forms-Pubs.

GSA per diem rates

The federal per diem rate is a combination of the lodging expense rate and the meal and incidental expense (M&IE) rate for the locality of travel. For travel within CONUS, the per diem rates published by the GSA may be used to substantiate certain travel expenses.

Instead of requiring employees to substantiate business travel expenses, employers may provide reimbursement in the form of a per diem allowance for each day of travel (see *The Payroll Source*®, p. 3-47). The amount of the per diem allowance is deemed substantiated so long as it does not exceed the federal per diem rates and the employee substantiates the time, place, and business purpose of the expenses. Per diem allowances that are equal to or less than the federal rates for the locality of travel are excludable from income, while per diem allowances exceeding the federal rates are treated as taxable wages subject to employment taxes to the extent of the difference between the allowance and the federal rate.

What's new this year

For the cities and locations within CONUS that are listed, the lodging rates range from a low of \$70 (unchanged) to a high of \$360 (up from \$317). The six M&IE rates are unchanged at \$39, \$44, \$49, \$54, \$59, and \$64.

For all locations within CONUS not shown on the list, the lodging per diem rate is \$70 and the M&IE rate is \$39, for a

combined maximum standard per diem rate of \$109. The combined per diem rates for the listed locations range from a low of \$109 (off-season) for South Haven, Michigan and Hot Springs, South Dakota, to a high of \$424 (peak season) for New York City.

High-low method

Because the GSA rates vary by locality, and in some places by the time of year, the IRS also offers a simplified "high-low" method for employers to use. A few dozen localities are identified as "high-cost" and the rest of the U.S. as "low-cost." The IRS also has special meal rates for workers in the transportation industry. Changes in these rates may also be effective October 1. Details on these rates will be included in a future issue of PAYROLL CURRENTLY.

OCONUS per diem rates

The Department of Defense updates the per diem lodging and M&IE rates for travel in non-foreign areas outside the continental U.S. (OCONUS), including Alaska, Hawaii, Puerto Rico, and the U.S. territories. Rate revisions, which are made via "Civilian Bulletins" on an irregular basis, are announced in the Federal Register (see, e.g., 73 F.R. 37938, 7-2-08, for the announcement of Civilian Bulletin 260 – rates effective 7-1-08). OCONUS rates are available on the Department of Defense website at <http://perdiem/hqda.pentagon.mil/perdiem> (click on "Per Diem Rates" and "Civilian Bulletin" and choose the most recent date).

Foreign per diem rates

The Department of State updates the per diem lodging and M&IE rates for travel in foreign areas. Note that these rate revisions are not announced in the Federal Register. The complete list of foreign per diems is updated monthly on the Department of State website at www.state.gov/travelandbusiness (click on "Foreign Per Diem Rates"). ■

SIFL Rates for 2nd Half of 2008 Announced

The Standard Industry Fare Level (SIFL) rates and the terminal charge for the period July 1, 2008 – December 31, 2008, have been issued. SIFL rates and the terminal charge are factors used to calculate the value of personal flights on employer-provided or commercial aircraft for purposes of federal income, FICA, and FUTA taxes.

For the second half of 2008, the terminal charge has increased to \$42.26 (from \$39.86). The SIFL rates have also increased to: \$0.2312 (from \$0.2180) per mile for the first 500 miles; \$0.1763 (from \$0.1662) per mile for miles 501 to 1,500; and \$0.1695 (from \$0.1598) per mile for miles over 1,500. ■

Specifications Issued for Private Printing of Forms 1042-S, 1096, 1098, 1099, 5498, and W-2G

In Rev. Proc. 2008-36 [2008-33 IRB 340], the IRS has published updated requirements for preparing acceptable paper substitutes for Forms 1042-S, 1096, 1098, 1099, 5498, and W-2G. Substitute forms must conform to the official IRS form or the specifications

in the revenue procedure to be acceptable. Rev. Proc. 2008-36 supersedes Rev. Proc. 2007-50 (2007-31 IRB 244).

The following changes have been made to the revenue procedure this year:

- **New e-mail address.** The Substitute Forms Unit e-mail address has changed to Substituteforms@irs.gov instead of *taxforms@irs.gov.

- **Address change.** The room number in the address of the Substitute Forms Unit has changed to Room 6526.

- **Sections reversed.** Old sections 1.2 and 1.3 of Part 1 (General Information) have been reversed to show a more logical sequence.

- **Logos, slogans, and advertising.** The IRS has received questions concerning whether substitute payee statements containing logos, slogans, or advertising are valid payee statements. The IRS originally anticipated responding to these questions by revising the regulations. However, it has been determined that it is not necessary to amend the regulations. Instead, guidance is being provided in this revenue procedure (see new section 1.3.2 of Part 1).

- **Where to file.** All information returns filed on paper will be filed with only two IRS centers: Austin, TX, and Kansas City, MO.

- **Magnetic media no longer acceptable.** All references to magnetic media have been removed from Publication 1179 and from all forms to which the publication refers. ECC-MTB will no longer accept tape cartridges for returns filed after December 1, 2008. After that date, electronic filing will be the only acceptable method for filing returns with ECC-MTB.

- **OCR specifications.** Additional OCR specifications have

been added to section 2.1.5 of Part 2.

- **Form 1099-R.** The following changes have been made to the Guide to Distribution Codes:

- For Distribution Code 1, the reference to the qualified reservist distribution under IRC §72(t)(2)(G) has been deleted due to the expiration of the provision.

- An exception has been added to Distribution Code 2 for distributions that are permissible withdrawals under an eligible automatic contribution arrangement under IRC §414(w).

- New Distribution Code H, Direct rollover of a designated Roth account distribution to a Roth IRA, has been added.

- Distribution Codes B and D are a valid combination for 2008.

- **Form 1042-S.** The boxes on Form 1042-S have been changed and reconfigured for 2008. The major changes are to:

- Boxes 7 through 9. These boxes are used to show the amount withheld, the amount withheld by other withholding agents, and the total amount of tax withheld.

- Box 15. This box is used to show the recipient's foreign tax identifying number, if any.

- Box 22. This box is used to show the recipient's account number (optional).

- **Editorial changes.** Redundancies have been eliminated as much as possible. ■

Tool Plan Payments Must Be Included in Employees' Gross Income, IRS Says

The IRS has released a coordinated issue paper on employee tool and reimbursement plans [LMSB-04-0608-037, 7-2-08; www.irs.gov/businesses/article/0,,id=97388,00.html]. The paper concludes that amounts paid to employees under tool and equipment plans the IRS "has seen to date" do not meet accountable plan requirements. Therefore, the payments must be included in the employees' gross income, must be reported as "wages or other compensation" on the employees' Forms W-2, and are subject to federal employment taxes.

Background

Employees in automobile, truck, and equipment dealerships, repair and body shops, and various other enterprises in several industries including aviation, agriculture, and construction, are hired to perform repair and maintenance services. As a condition of employment, the employees are required to provide and maintain their own tools and equipment, which may be kept on-site at the business locations or stored at home. Generally, the tools and equipment – which may range from simple tools to sophisticated electronic and computer equipment – are used exclusively by the employee to whom they belong.

Many tool plans are being marketed to employers in these industries. The tool plans are administered either by a third party for a fee or by the employer, and purport to operate as accountable plans.

Analysis

Amounts paid to employees for the use of their tools and equipment can be excluded from wages only if paid under an accountable plan. A plan must satisfy the accountable plan requirements of business connection, substantiation, and return of excess (see *The Payroll Source*®, pp. 3-44 and 3-45) in order for payments made under it to be excludable

from wages. Based on the arrangements the Service has seen, amounts paid to employees under tool plans do not satisfy these requirements. However, the facts of each arrangement should be reviewed.

The tool plans reviewed for purposes of this paper designate a portion of an employee's existing compensation and label it as a "nontaxable reimbursement" until the employee's total amount of tool inventory has been paid out, at which point the portion is again designated as taxable wages. Employees receive the same gross pay before, during, and after they are "reimbursed" for expenses.

Business connection requirement. Where an employee is paid the same gross pay, including the portion temporarily designated as a tool allowance, without regard to whether expenses are incurred or reasonably expected to be incurred, the arrangement fails to meet the business connection requirement.

Two employees who have the same inventory of tools but who pay or incur very different expenses for an employer because of their different history of purchases, past reimbursements and/or depreciation, would nonetheless receive the same total amount through tool allowance payments.

Tool allowance payments made in this way lack a logical connection to expenses incurred or reasonably expected to be incurred and therefore fail to meet the business connection requirement.

Substantiation requirement. Substantiation must be made on a timely basis and must establish what expenses were incurred for the employer – the amount, time, place, and business purpose of each such expense. Fair tool and equipment rental or replacement value, without more, does

not satisfy the substantiation requirement because it does not take into account information about the acquisition date and amount of, or the specific nature of, any expenses paid or incurred by the employee for the employer and not previously reimbursed.

Furthermore, by taking into account the employee's entire existing inventory, whether determined by reference to value or cost, without taking into account the employee's prior history of depreciation or reimbursement for the expenses incurred in the tools listed, tool plans fail to even reasonably estimate expenses actually incurred.

Requiring receipts for new expenses provides substantiation for those particular expenses, but does not salvage the substantiation failures in the design or operation of the remainder of the tool plan.

Return of excess requirement. Employees must be required to return to the payer within a reasonable period of time any amount paid in excess of expenses substantiated. Because tool plans do not substantiate expenses, they also do not require employees to return amounts in excess of substantiated expenses.

Pattern of abuse. Generally, the failures of the tool plans

under review to satisfy accountable plan requirements are not isolated with regard to a particular employee or period of time. Rather, the failures appear to be routine and fundamental to the design of the plans. The goals are: (1) to ensure that the gross pay of each employee remains the same, regardless of whether the employee incurs or is reasonably expected to incur expenses for the employer, (2) while generating tax savings for both the employer and employee by "reimbursing" the employees with funds that would otherwise be payable to them as taxable wages and will again be paid to them as wages once the "reimbursements" are completed.

The accountable plan rules were not meant to allow taxpayers to avoid paying taxes, even for a short period of time, in the guise of expense reimbursement. The routine reimbursement of unsubstantiated expenses and the practice of recharacterizing wages as reimbursements until the employee's tool inventory value is zeroed out, only to reinstate the original wage amount at that point, "evidence a pattern of abuse of the accountable plan rules." Therefore, payments made under these plans should be treated as made under a nonaccountable plan. ■

IRS Updates Electronic Filing Requirements for Form 1042-S

The IRS has issued a revenue procedure providing specifications for filing Form 1042-S electronically [Rev. Proc. 2008-44, 2008-30 IRB 187; www.irs.gov/irb/2008-30_IRB/ar18.html]. The new revenue procedure supersedes Rev. Proc. 2006-34, and is reproduced as the current version of Publication 1187, *Specifications for Filing Form 1042-S, Foreign Person's U.S. Source Income Subject to Withholding, Electronically*. The new revenue procedure must be used to prepare current and prior year information returns filed beginning January 1, 2009. Changes to note for tax year 2008 include the following:

- Editorial changes have been made throughout the publication for clarity.
- The record length for all records (T, W, Q, C, and F) has been increased to 20 positions.
- IRS/ECC-MTB no longer accepts any form of magnetic media. Electronic filing through the FIRE system is the only method to report Form 1042-S to IRS/ECC-MTB.
- The title of Publication 1187 has been changed (see above) to reflect the elimination of magnetic media filing.
- Form 4804, *Transmittal of Information Returns Reported Magnetically*, is obsolete. This form was only required for magnetic media reporting.
- Test procedures have been eliminated from Part A since

tape cartridges will not be acceptable after December 1, 2008. Electronic filing specifications, Part B, Sec. 3, details testing procedures for electronic files.

- Form 8809, *Application for Extension of Time to File Information Returns*, is available as a fill-in form on the FIRE system; its use is highly encouraged in lieu of the paper version of the form (see Part D, Sec. 1).
- Several sections have been deleted due to the elimination of magnetic media filing and others combined for greater clarity.
- Part A, Sec. 9, Amended Returns, has been extensively revised. A chart has been added detailing the one- and two-step amended process.
- Part A, Sec. 8, .10 has been expanded to give detailed instruction on how to report "UNKNOWN RECIPIENT."
- For the Withholding Agent "W" Record, additional instructions have been added to the Return Type Indicator field and Postal or ZIP Code field.
- For the End of Transmission "F" Record, Media Count, positions 5-7 have been eliminated. Positions 5-810 are reserved.
- Major format changes have been made to the Recipient "Q" Record. New fields have been added and others have been moved to new locations within the record. ■

September 1-5 Is National Payroll Week

During the week of September 1-5, payroll professionals across the nation will celebrate National Payroll Week (NPW). Founded by the APA in 1996, NPW celebrates the hard work of America's 156 million wage earners and the payroll professionals who pay them. Together, through the payroll withholding system, they contribute, collect, report, and deposit approximately \$1.7 trillion, or 64.2%, of the annual revenue of the U.S. Treasury. Visit www.nationalpayrollweek.com to:

- volunteer to teach teens in your community all about their paychecks and the withholding system on Money Matters National Education Day, September 4 (using the special lesson

plan designed by the APA and the National Council on Economic Education);

- find out more about NPW and the many ways your company can participate;
- take the "Getting Paid In America" online survey (and enter to win a free paycheck and a trip for two to Las Vegas);
- download the 2008 NPW artwork;
- send the free e-card;
- learn about NPW contests for APA chapters and individuals;
- access the helpful "My Paycheck" web page; and
- shop online in the NPW Store. ■

IRS Issues Proposed Regulations on Employee Stock Purchase Plans

The IRS has issued proposed regulations on stock options granted under an employee stock purchase plan (ESPP) [73 F.R. 43875, 7-29-08; <http://edocket.access.gpo.gov/2008/pdf/E8-17255.pdf>]. The proposed regulations would provide a comprehensive set of rules for ESPPs that updates existing regulations under IRC §423 – incorporating statutory changes, providing additional guidance, and removing obsolete rules.

General requirements. Under the proposed regulations, the plan and the terms of an offering must be in written or electronic form.

The proposed regulations list the requirements that must be met in order for a plan to qualify as an ESPP:

- The plan must provide that the plan can be granted only to employees of the employer corporation or a related corporation to purchase stock in any such corporation;

- The plan must be approved by the stockholders of the granting corporation within 12 months before or after the date the plan is adopted;

- Under the terms of the plan, an employee cannot be granted an option if, immediately after the option is granted, the employee owns stock with 5% or more of the total combined voting power or value of all classes of stock of the employer corporation or a related corporation;

- Under the terms of the plan, options must be granted to all employees of any corporation whose employees are granted any options by reason of their employment by the corporation;

- Under the terms of the plan, all employees granted options must have the same rights and privileges;

- Under the terms of the plan, the option price cannot be less than the lesser of:

- an amount equal to 85% of the fair market value of the stock at the time the option is granted, or

- an amount not less than 85% of the fair market value of the stock at the time the option is exercised;

- Under the terms of the plan, options cannot be exercised after the expiration of:

- 5 years from the date the option is granted if, under the terms of such plan, the option price cannot be less than 85% of the fair market value of the stock at the time the option is exercised, or

- 27 months from the date the option is granted, if the option price cannot be less than an amount equal to 85% of the fair market value of the stock at the time the option is granted;

- Under the terms of the plan, no employee may be granted an option that permits the employee's rights to purchase stock under all employee stock purchase plans of the employer corporation and its related corporations to accrue at a rate that exceeds \$25,000 of fair market value of the stock (determined at the time the option is granted) for each calendar year in which the option is outstanding at any time; and

- Under the terms of the plan, options are not transferable by the employee other than by will or the laws of descent and distribution, and are exercisable, during the lifetime of the employee, only by the employee.

Shareholder approval of the ESPP. The proposed regulations, like existing regulations, would require stockholder approval if there is a change in the aggregate number of shares or in the employees eligible to be granted options under the

plan. The proposed regulations would clarify the requirements for stockholder approval and would provide a more comprehensive list of situations that require new stockholder approval of the plan. In particular, the proposed regulations would clarify that new stockholder approval is required if there is a change in the shares with respect to which options are issued or a change in the granting corporation.

Maximum aggregate number of shares. The proposed regulations would provide that the plan may specify that the maximum aggregate number of shares available for grants under the plan may increase annually by a specified percentage of the authorized, issued, or outstanding shares at the date of the adoption of the plan.

Employees covered by the plan. The proposed regulations have been updated to substitute “highly compensated employees (within the meaning of §414(q))” for “officers, persons whose principal duties consist of supervising the work of other employees, or highly compensated employees.”

The proposed regulations would provide that an ESPP does not fail to satisfy the coverage provision of §423(b)(4) merely because the plan excludes employees who have completed a shorter period of service or whose customary employment is for fewer hours per week or fewer months in a calendar year than is otherwise required, provided the exclusion is applied in an identical manner to all employees of every corporation whose employees are granted options under the plan.

Equal rights and privileges. The proposed regulations would provide that a plan or offering will not fail to satisfy the requirements of §423(b)(5) if, in order to comply with the laws of a foreign jurisdiction, the terms of an option granted under a plan or offering to citizens or residents of such foreign jurisdiction (without regard to whether they are also citizens of the U.S. or resident aliens) are less favorable than the terms of options granted under the same plan or offering to employees resident in the U.S.

Option price. The proposed regulations would provide that the option price may be determined in any reasonable manner, including the valuation methods permitted under estate tax regulation §20.2031-2, so long as the option price meets the minimum pricing requirements of §423(b)(6).

Date of grant. The proposed regulations would provide that, for purposes of options granted under an ESPP, the principles of IRC regulation §1.421-1(c) shall be applied without regard to the requirement that the minimum option price be fixed or determinable in order for the corporate action constituting an offer of stock to be considered complete. As a result, the first day of an offering could be the date of grant of an option issued under an ESPP even though the minimum option purchase price is not fixed or determinable on the first day of the offering.

Annual \$25,000 limitation. The proposed regulations would provide that the \$25,000 limit for ESPPs is, to the extent possible, calculated in a manner consistent with the \$100,000 limitation for incentive stock option plans. The timing of both measures is based on when the option first becomes exercisable, and both measures are made based on the fair market value of the stock determined at the date of grant.

Effective date

The regulations are proposed to apply to any option issued under a §423 ESPP that is granted on or after January 1, 2010.

However, taxpayers may rely on the proposed regulations for the treatment of any option issued under an ESPP that is granted after July 29, 2008.

Comments

Comments on the proposed regulations must be

received by October 27, 2008. Send written comments to: CC:PA:LPD:PR, Room 5203, Internal Revenue Service, P.O. Box 7604, Ben Franklin Station, Washington, DC 20044. Or submit comments electronically at: www.regulations.gov. Be sure to reference IRS REG-106251-08. ■



STATE AND LOCAL NEWS

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Connecticut

PEO registration now required. Effective 1-1-09, a professional employer organization (PEO) operating in Connecticut must register with the Labor Commissioner by 3-1-09. PEOs not yet operating in Connecticut as of 1-1-09 must register before beginning operations in the state. PEOs must file audited financial statements every year and maintain a minimum of \$150,000 in working capital or provide a bond, irrevocable letter of credit, or securities of not less than \$150,000, except where a PEO is granted a limited registration [H.B. 5113, L. 2008].

New Jersey

TDI and FLI taxable wage base and employee contribution rates (2009) announced. For 2009, the temporary disability insurance (TDI) taxable wage base will increase to \$28,900 from the 2008 wage base of \$27,700 (this updates *The Payroll Source*®, p. 7-42). The employee contribution rate remains 0.5% of annual earnings up to the wage base. This converts to a maximum employee contribution of \$144.50. The new employer contribution rate remains 0.5% of annual earnings up to the wage base.

For 2009, the family leave insurance (FLI) taxable wage base will be \$28,900. The employee contribution rate is 0.09% of annual earnings up to the wage base (in addition to the TDI employee contribution rate). This converts to a maximum employee contribution of \$26.01. Effective 7-1-09, an eligible employee may take up to six weeks of FLI to care for a family member with a serious health condition or to be with a child during the first 12 months after the birth or adoption of the child [Department of Labor and Workforce Development, Notice, Division of Employer Accounts 2009 Rates].

UI taxable wage base and employee contribution rate (2009) announced. The 2009 unemployment insurance (UI) taxable wage base will increase to \$28,900 from the 2008 wage base of \$27,700 (this updates *The Payroll Source*®, p. 7-23). Effective 7-1-08 through 6-30-09, the employee tax rate remains 0.425%. This converts to a maximum employee deduction of \$122.83 [Department of Labor and Workforce Development, Notice, Division of Employer Accounts 2009 Rates].

Oregon

Electronic registration and payment option now available. Employers may now register online for combined payroll taxes (i.e., state income tax, transit tax, and unemployment insurance tax) by using the Oregon Central Business Registry (CBR) at <https://secure.sos.state.or.us/ABNWeb>. Also, employers may now use the direct debit method to pay state withholding and transit tax bills electronically. The Department of Revenue (DOR) does not charge a fee for this service [DOR, *Payrolltax News*, 7-08].

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